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December 22, 2003

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station
Boston, MA 02110

Re: D.T.E. 03-47-A, Boston Edison Company, Cambridge Electric Light Company, Commonwealth Electric Company, NSTAR Gas Company, Pension/PBOP Adjustment Factor Compliance Filing

Dear Secretary Cottrell:

By this letter, Boston Edison Company, Cambridge Electric Light Company, Commonwealth Electric Company and NSTAR Gas Company (together, the "Company") respond to the Attorney General's letter dated December 10, 2003, requesting that the Department of Telecommunications and Energy (the "Department") allow discovery,[1] hearings and briefs on the Company's calculation of the Pension Adjustment Factor (the "PAF").[2] The Attorney General claims that a full "examination" is necessary because (1) the Company's PAF schedules contain "new, subjective and undocumented information;" and (2) the schedules were not presented during the hearings in this case (Attorney General Letter at 1). As described below, the Company's PAF Filing is based directly on the sample calculation presented in DTE-1-4(Rev) in D.T.E. 03-47-A and incorporates the exact amounts and calculations presented in that exhibit except where necessary to institute changes expressly required by the Department's Order.

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1 The Company has already responded to 27 information requests issued by the Attorney General and one issued by the Department in relation to this compliance filing.

2 On December 1, 2003, the Company filed with the Department: (1) compliance tariffs to establish a Pension/PBOP Adjustment Mechanism for each NSTAR retail company pursuant to the Department's directives in Boston Edison Company, Commonwealth Electric Company, Cambridge Electric Light Company and NSTAR Gas Company, D.T.E. 03-47-A (2003) (the "Order"); and (2) the Company's first annual Pension/PBOP Adjustment Factors for effect January 1, 2004 (the "PAF Filing"). Although motions for clarification and reconsideration of the Order are now pending before the Department, the issues raised in the motions do not require resolution by the Department prior to its approval of the compliance tariffs and PAF Filing. The compliance tariffs and PAF Filing serve only to implement the terms of the Department's Order and present no new information or calculations for the Department's consideration.

In that regard, the Attorney General claims that the Department should investigate at least five topics, including: (1) the balance of prepaid pension and PBOP amounts; (2) the actual amount of pension and PBOP expense included in the PAF calculation; (3) the level of pension and PBOP expense amounts currently included in rates; (4) the amount of pension and PBOP regulatory asset balances that have been deferred as a result of the Department's decisions in Boston Edison Company, D.P.U. 92-92 (1992) and Cambridge Electric Light Company, D.P.U. 92-250 (1993); and (5) the level of carrying charges allowed by the Department's Order (Attorney General Letter at 2-4). However, the record in D.T.E. 03-47 is clear on all of these points and the Attorney General's request for hearings represents an attempt to re-litigate issues already determined by the Department. Accordingly, the Department should deny the Attorney General's Motion.

(1) Prepaid Pension and PBOP Balances

The Attorney General claims that there are three reasons that the Department should investigate the prepaid amounts, which are: (1) there is no disaggregation of these balances to remove the prepaid amounts for non-retail businesses including generation, transmission and the holding company; (2) the prepaid amount balances are derived from the pension and PBOP actuarial studies requiring review of the underlying assumptions; and (3) a factor of 0.82 and 0.83 is applied, "without explanation" to determine the amount of deferred income taxes deducted from the prepaid balances (Attorney General Letter at 2). None of these claims has merit.

First, in terms of disaggregating the prepaid amounts among regulated and non-regulated companies, the record in D.T.E. 03-47 established that the prepaid pension and PBOP amounts included in the sample calculation presented in DTE-1-4(Rev), and duplicated in the PAF Filing, are the portion of the prepaid balances that relate exclusively to the four regulated retail companies.[3] Thus, it is not necessary or appropriate to "disaggregate" the balances included in the PAF Filing among the non-retail generation, transmission and holding company businesses.

Second, the Department's Order recognizes that prepaid amounts are the difference between amounts booked by the Company pursuant to SFAS 87 and SFAS 106 and cash amounts contributed by the Company to its pension and PBOP trust funds. Order at 33-34. Pension and PBOP prepaid balances are presented in the PAF Filing only for the purpose of calculating the carrying costs, which apply to the average annual

[3] The Company provided a comprehensive discussion of the derivation of the prepaid pension and PBOP amounts for 2002 and 2003 in the PAF Filing in response to the Attorney General's Information Requests AG-1-4, AG-1-5, AG-1-10 and AG-1-11, which were issued in relation to the compliance filing. In the 2004 PAF Filing, the Company will allocate the prepaid amounts based on actual, total-year 2003 labor benefits expenses. Please refer to the Company's response to Information Request AG-1-4.

balance of prepaid pension and PBOP expense. In D.T.E. 03-47, the Company calculated the average annual balance of pension and PBOP prepaid amounts by averaging the balances as of December 31, 2002 and December 31, 2003.[4] See, Exhibit DTE-1-4 (Rev), at Line 12. The amounts used in the PAF Filing (at lines 9 and 14) to calculate the prepaid pension and PBOP balances are the same as the amounts shown in Exhibit DTE-1-4 (Rev)(Line 12).

Moreover, there is no need to investigate the actuarial assumptions underlying the calculation of the projected 2003 SFAS 87 and SFAS 106 expense, which forms the basis of the prepaid balance calculation. The total prepaid pension and PBOP balances as of December 31, 2002 are computed as the difference between cash contributions to the fund in previous years and the Company's booked SFAS 87 and SFAS 106 expense. The actual 2003 prepaid balances will be known at the time the Company files its next PAF Filing in December 2004, and therefore, the Company expects that it will true-up to the actual 2003 prepaid balance by entity in that filing. As a result, it is not necessary or appropriate to expend resources at this time to "investigate" the assumptions underlying the actuarial studies that form the basis of the estimated 2003 SFAS 87 and SFAS 106 expense.

Third, the factors applied to determine the amount of deferred income taxes deducted from the prepaid balances were established in D.T.E. 03-47. See, e.g., Exhibit DTE-2-19 in D.T.E. 03-47. The Company provided a comprehensive response to the Attorney General's Information Request AG-1-6 on the PAF Filing, which referenced the record in D.T.E. 03-47 and explained that these factors reflect the capitalization rate applicable under Section 263A of the Internal Revenue Code.

Lastly, it should be noted that the Attorney General was provided with the full and fair opportunity to challenge or rebut the accuracy of these prepaid balance amounts in D.T.E. 03-47 and the Attorney General failed to do so. Granting additional hearings in this proceeding at this point in time would not produce any new information, nor would it be appropriate given that these amounts were presented and considered by the Department in D.T.E. 03-47.

(2) Pension/PBOP Expense Levels

The Attorney General claims that the Company's pension and PBOP expenses for 2003 must be "tested for appropriateness" regarding: (1) the actuarial assumptions underlying the projected expense; (2) the amount of costs allocated to regulated and non-regulated businesses; and (3) the capitalization rate. As with the Attorney General's other claims, it is not necessary or appropriate for the Department to investigate these issues in the context of this filing.

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[4] As discussed below, the prepaid balances will be subject to reconciliation in the 2004 PAF Filing.

First, in terms of the actuarial assumptions underlying the 2003 expense, the Attorney General ignores the fact that (1) under the reconciliation mechanism, the Company recovers no more and no less than its booked SFAS 87 and SFAS 106 expense; and (2) the year-to-year calculation of SFAS 87 and SFAS 106 expense inherently accounts for the differences between the actuarial assumptions and actual experience in a given year, i.e., the expense derived under SFAS 87 and SFAS 106 in any given year is, in part, dictated by the reconciliation of actual experience in the current year to the actuarial assumptions made in the past year. The actuarial assumptions underlying the pension/PBOP expense calculation were presented in D.T.E. 03-47 (see, DTE-2-7 and AG-1-9). As a result, there is no need to investigate the actuarial assumptions underlying the calculation of the projected 2003 SFAS 87 and SFAS 106 expense.

Second, the calculations in the PAF Filing are based on the same allocation percentages and capitalization rates set forth in D.T.E. 03-47, at Exhibit DTE-1-4 (Rev). Specific references to the record in D.T.E. 03-47 are provided in response to Information Request AG-1-15, AG-1-18, AG-1-19 and AG-1-20 issued by the Attorney General on the PAF Filing. As stated therein, the capitalization rates are based on the historical proportion of company labor dedicated to capital work. The Company expects to true-up the 2003 allocation percentages and capitalization rates based on final actual results that will become available in 2004. As a result, further proceedings would not produce any new information, nor would it be appropriate to expend resources at this time to "investigate" the allocation percentages or capitalization rates.

The Attorney General was provided with the full and fair opportunity to challenge or rebut the accuracy of the SFAS 87 and SFAS 106 expense amounts in D.T.E. 03-47 and the Attorney General failed to do so. Granting additional hearings in this proceeding at this point in time would not produce any new information, nor would it be appropriate given that these amounts were presented and fully considered by the Department in D.T.E. 03-47.

(3) Pension/PBOP Amounts in Rates

The Attorney General claims that the Department should investigate and determine the amount of pension and PBOP expense included in rates. As explained by the Company in responses to the Attorney General's information requests on the PAF Filing, the level of Company pension and PBOP expense amounts currently included in rates was established on the record in D.T.E. 03-47-A.[5] The Company used the same amounts in the PAM-1 tariff and the PAF Filing at page 1, line 3 (divided by one-third to reflect the four-month period September through December 2003). The evidentiary

[5] See responses to Information Requests AG-1-1, AG-1-4, AG-1-5, AG-1-9, AG-1-10 and AG-1-11 filed on December 17, 2003, in answer to the Attorney General's compliance discovery.

record on the amount of pension/PBOP costs in rates is clear and uncontested, and therefore, it would be inappropriate for the Department to reopen evidentiary hearings to reconsider the record evidence in the compliance phase of this proceeding.[6]

(4) Deferral Balances

The Attorney General claims that new additional evidentiary hearings are needed to examine the amount of pension and PBOP regulatory assets balances that have been deferred as a result of the Department's decisions in: (1) Boston Edison Company, D.P.U. 92-92 (1992); and (2) Cambridge Electric Light Company, D.P.U. 92-250 (1993) (Attorney General Letter at 3-4). This request should be denied by the Department because the record in this case includes a full discussion and identification of these deferral balance amounts, both of which were not challenged or rebutted by the Attorney General during the hearings. In addition, the Department's Order explicitly approves the recovery of these deferral balances. Order at 45. To allow further examination of this information in the compliance phase of this proceeding is tantamount to the Department granting a motion for reconsideration where the record is clear and no error has been shown.[7]

(5) Carrying Charges

The Attorney General claims that when the Department allowed a return on the prepaid balances, it did not recognize or make any provision for grossing up that amount for income taxes (Attorney General Letter at 4). According to the Attorney General, the carrying charge rate should therefore be based on 8.16 percent, and not the 10.88 percent carrying charge used by the Company, which has been grossed up for income taxes. The Attorney General's argument seeks to create confusion where none is present, and should be rejected by the Department.

Both the record in the case and the Department's Order are clear that the return allowed by the Department will be grossed-up for income taxes. Indeed, the Department consistently has adopted a gross-up mechanism to incorporate the effect of income taxes

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6 This issue is also the subject of the Attorney General's separate Motion for Clarification, or the in the Alternative, for Reconsideration, dated November 20, 2003. As stated in the Company's response to the Attorney General's November 20 Motion, the amount of pension/PBOP expense in rates was determined in D.T.E. 03-47.

7 As stated in the Company's response to Information Requests AG-1-24 and AG-1-25 of the PAF Filing, Exhibit AG-1-44 in D.T.E. 03-47 presented the workpapers that detail the calculation of the 2003 beginning balance of the Boston Edison deferred pension costs relating to D.P.U. 92-92 and Cambridge Electric Light Company's deferred PBOP balances relating to D.P.U. 92-250. In addition, the prefiled testimony of Mr. Judge described the inclusion of these deferred balances in the Company's Pension Adjustment Mechanism, and specifically identified the unamortized balances associated with these deferrals. Exhibit NSTAR-JJJ at 32-33. This information was again included in Exhibit DTE-1-4 (Rev) at 2 (notes 1 and 2).

when calculating the allowed rate of return. See e.g., Western Massachusetts Electric Company, D.P.U. 86-280-A at 40 (1997) ("[The Department] ha[s] adjusted the net-of-tax rates of return used to compute the return, carrying charges and amortization, to reflect our findings as to the appropriate tax rates and cost of capital for the various periods over which the return, carrying charges and amortization are computed, as determined in this Order"). Mr. Judge testified that "the return will be based on the *tax-effected* weighted average cost of capital for each distribution company, as most recently applied by the Department." Exhibit NSTAR-JJJ at 33 (emphasis added). In addition, the Department's Order states that the "final component of the Companies' proposal is the recovery of carrying charges (or money costs), *based on the tax-effected* weighted cost of capital of each of the Companies . . ." Order at 33. Accordingly, no additional hearings are appropriate or necessary to examine the Department's allowed carrying costs in this case.

(6) Conclusion

The annual PAF factors will become effective on January 1 of each year based on financial data from the prior calendar year. By definition this means that the annual filing will precede the availability of complete and final financial data. The annual filings will involve amounts that are based, in part, on amounts established in D.T.E. 03-47 that do not change from year to year, and in part, on forecasted amounts that will need to be subsequently reconciled. As a result, there is no need to litigate every element of a reconciling formula, such as the transition charge, cost of gas adjustment charge and other reconciling mechanisms, before the factor is placed in rates. In general the Department routinely approves such rates, without full hearings, subject to a later true-up to actual amounts as the estimated amounts become finalized. In this specific matter, the Company's PAF Filing is entirely consistent with the numbers, methodologies and schedules presented in D.T.E. 03-47. The Attorney General has not raised any issues absent from the initial case and seeks only to relitigate issues already determined by the Department.

Accordingly, the Company requests that the Department approve the compliance filing and PAF for effect on January 1, 2004.[8]

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[8] It is imperative that the PAF go into effect on January 1, 2004, coincident with new transition, standard offer, transmission and default service adjustment rates for Boston Edison, Cambridge and Commonwealth. The Company designed these rates (which must meet the statutory 15 percent, inflation adjusted rate reduction for standard offer service customers) based on the implementation of the PAF on January 1, 2004. Any delay in the implementation of the PAF would require changes in the other rates that are to go into effect on that date. See filings in D.T.E. 03-117 and D.T.E. 03-118.

Thank you for your attention to this matter.

Sincerely,

Robert J. Keegan / bl

Robert J. Keegan

Enclosures

cc: Service List